

Investment Research
Pharmaceuticals

Matrix Laboratories Limited

CMP Rs. 222.0

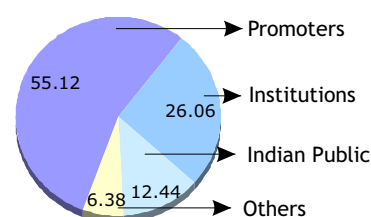
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Stock Codes

Bloomberg : HDPH.IN
Reuters : HERE.BO
BSE Code : 524794
NSE Code : MATRIXLABS
BSE Group : B1

Share Holdings (%)

As on 30th September, 2006.



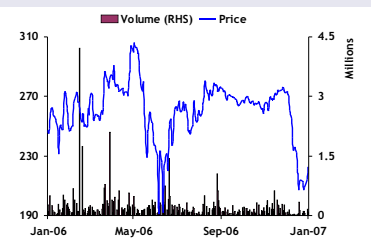
Stock Data

Sensex : 14057.0
Nifty : 4052.0
52 W High Rs. : 312.80
52 W Low Rs. : 184.0
Mkt Cap (Rs mn) : 34106.0
No of Shares : 15.4 Crs
Face Value : Rs. 2.0

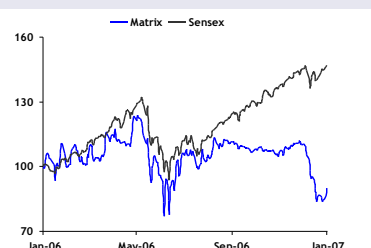
Absolute Returns

%	1M	3M	6M
Matrix Labs	-18.59	-16.21	-16.35
Sensex	0.55	13.12	30.15

Price/Volume



Price Comparison



Matrix Laboratories Limited (MLL) is engaged in the manufacture of Active Pharmaceutical Intermediates (APIs) and Solid Oral Dosage Forms with turnover of US\$ 261 million. It is one of the fastest growing API manufacturers in India and focuses on regulated markets such as U.S. and EU. The company has a wide range of products in CNS, anti-bacterial, anti-AIDS, anti-asthmatic, cardiovascular, gastrointestinal, anti-fungal, pain management and life style related therapeutic segments.

Out of Ten, Six API manufacturing facilities of the Matrix Group are approved by the U.S. FDA. The combined FDA approved capacity of the company is one of the largest in the country. The company's Finished Dosage Forms (FDF) manufacturing facility has a capacity to manufacture 2 billion tablets and 300 million capsules on two-shift basis. With about 2,300 employees, including over 300 R&D scientists, Matrix focuses on developing APIs with non-infringing processes to partner with generic players in regulated markets for their early formulation entry.

It has recently acquired Docpharma Belgium, for a front-end presence in Belgium, the Netherlands and Luxembourg. In addition, MLL has a controlling stake in Mchem (China) and Concord Biotech India. Newbridge Capital / TPG Ventures, U.S. and Temasek Holdings, Singapore were the strategic investors in MLL with a combined holding of about 40 percent prior to Mylan's acquisition of the controlling stake by Mylan laboratories .

About Mylan Laboratories Inc.

Mylan Laboratories Inc. (US \$ 1.3 billion) is a leading pharmaceutical company with three principal subsidiaries: Mylan Pharmaceuticals Inc., Mylan Technologies Inc. and UDL Laboratories Inc. It develops, licenses, manufactures, markets and distributes an extensive line of generic and branded generic pharmaceutical products. Mylan, headquartered in Canonsburg, PA, has production facilities in, West Virginia, Vermont, Illinois, Texas and Puerto Rico. It is having presence across 46 therapeutic segments with strength of more than 400 products. It anticipates obtaining approval of over 100 new products over the next five years.

Investment argument

Win - Win Deal : Mylan acquired 71.50% stake in Matrix Lab at Rs. 306 per share. This included a 51.50% stake from private equity investors and existing promoters and the open offer of 20%. Mr. Prasad (Promoter & Chairman) will retain 5% stake. He will remain on MLL's board as the Non-Executive Vice Chairman.

This is win-win deal for both Matrix Lab and Mylan Laboratories for the following reasons:

1. Mylan and Matrix together will have approximately 5,100 employees in 10 countries. Matrix will provide Mylan with a significant presence in important

Presence in important emerging pharmaceutical markets and cost rationalisation through backward integration for Mylan

emerging pharmaceutical markets, including India, China, and Africa, as well as a European footprint and distribution network through Matrix's Docpharma subsidiary. By combining Matrix's active pharmaceutical ingredient (API) and drug development business with Mylan's expertise in finished dosage forms (FDFs), this transaction also will allow Mylan to capture incremental pieces of the value chain through backward vertical integration.

Strong US presence and financial support with expertise in product development for Matrix

2. As part of the Mylan organization, Matrix will benefit from a strong U.S. presence, expanded production capabilities and manufacturing capacity and industry-leading expertise in product development and process optimization. Together, they will be able to compete more effectively while delivering cost savings to their customers. It provides Matrix Labs with a strong financial support to grow both organically and inorganically.

Broader product portfolio opportunities with significant cost savings for Mylan

3. Matrix is the world's second largest API player with respect to the number of drug master files (DMFs), with over 165 APIs in the market or under development, and 10 APIs and pharmaceutical intermediate manufacturing facilities, six of which are FDA approved. Matrix has diverse API capabilities, knowledge of the API patent landscape, capability in early API development, a low cost structure and strong scientific capabilities. Matrix's API manufacturing platform will provide Mylan with significant cost savings. This is of great significance as global generics majors are witnessing an erosion in margins. Their Finished Dosage Form pipeline will expand Mylan's forms and therapeutic categories and allow Mylan to pursue a broader portfolio of product opportunities more economically.

4. MLL will expand Mylan's capabilities in a number of key areas including products with higher barriers to entry and long-term growth opportunities, and allow the company to pursue a broader portfolio of new products at lower costs.

It will increase ANDA submissions and provide manufacturing flexibility allowing Mylan to manage industry cycles.

5. MLL's presence in Asia and Africa provides Mylan with access to multiple, under-penetrated and growing new markets. In addition, Matrix's strong development capabilities and access to India's highly skilled, scientific talent pool will allow Mylan to increase its number of Abbreviated New Drug Application (ANDA) submissions. MLL's additional manufacturing capabilities will provide Mylan with maximum manufacturing flexibility, allowing it to better manage industry cycles, while optimizing market share and gross margins.

It will increase expand Mylan's "high-barrier-to-entry" product capabilities in the area of ARVs

6. MLL is currently the world's largest supplier of generic anti-retroviral (ARV) APIs. Matrix also expands Mylan's "high-barrier-to-entry" product capabilities, particularly in the area of anti-virals. Through its ARV franchise, Mylan and Matrix intend to partner with international programs to bring lower-cost treatment solutions to patients in regions of the world most affected by HIV.

Organizational Structure and Management post deal

While Mylan has acquired a 71.50% stake in MLL, Mr. N Prasad (Promoter & Chairman) has retained a 5% stake. He will remain on Matrix board as Non-Executive Vice Chairman with Mr. Robert Coury (Vice Chairman & CEO of Mylan) taking over as the Chairman. Mr. Rajiv Malik will remain as CEO of Matrix. Mr. Stijn Van Rompay, co-founder of Docpharma, will remain responsible for the Docpharma operations. Further Mr. Prasad joins Mylan Board and Executive Management Team as Head of Global Strategies. This is a positive development for MLL per se.

MLL's China presence

Matrix has a controlling stake in Mchem Group (China). This provides it with a geographical advantage. It can leverage this by sourcing Pharmaceutical Intermediates from China, which can supply them at a lower cost than Indian firms. These intermediates will then convert into APIs in the Indian facilities for dispatch to customers and will further reduce costs and increase margins.

MLL's European Acquisition

MLL acquired Docpharma (Belgium) in October, 2005 for an enterprise value of US\$263 million. It was one of the largest acquisition by an Indian Pharma Company. Docpharma is a leading marketer of branded generics in Belgium, the Netherlands and Luxembourg. The Docpharma acquisition will provide Matrix with a robust marketing and distribution platform for future products, resulting in a direct presence in Europe and the generically under-penetrated Belgium, Netherlands, France and Italy. Matrix has developed a number of finished dosage forms and it will be able to leverage on the above acquisition to distribute these products across Europe. MLL has a target of increasing its product portfolio from 50 to 130 in next two years. It has contributed approximately 13% to consolidated PAT for the year ended March 2006.

Also, this in turn allows Mylan to distribute products from its broad portfolio into these markets, creating substantial additional distribution opportunities for Mylan's products, extending their growth cycle, and allowing Mylan to capture incremental revenues. Mylan's resources and products will accelerate Docpharma's expansion into existing markets, as well as support expansion into multiple new European markets through both organic growth and acquisitions. Mylan also plans to pursue the distribution of Docpharma's novel, existing products and development pipeline in the U.S. in areas such as female health and oncology. This will increase revenues for both Mylan Lab and Matrix.

Conclusion

MLL is the world's second largest API player with respect to the number of drug master files (DMFs), with over 165 APIs in the market or under development, and 10 API and pharmaceutical intermediate manufacturing facilities, 6 of which are US FDA approved. Acquisition of Matrix by a global leader like Mylan is a win-win situation for both companies.

The stock is currently trading at around 11x and 8x of FY 08E EPS of Rs. 21 and FY 09E EPS of Rs. 29 respectively. The risk to our recommendation includes risk pertaining to the generics business and APIs where margins are witnessing erosion due to fierce competition. It also includes lack of clarity on transfer pricing between Matrix and Mylan.

Summary Financials

Particulars (Rs Mn)	2005	2006	2007E	2008E	2009E
PAT	1302.0	1992.0	2336.0	3238.0	4367.0
EPS	8.5	11.7	15.3	21.1	28.5
P/E	26.1	19.0	14.6	10.5	7.8
EV/EBDITA	22.4	21.3	13.0	9.6	7.1
P/BV	5.3	3.3	2.8	2.3	1.8
ROE	32.1	17.2	20.5	23.7	26.0

Standalone Financials

P & L (Mn)	FY 03	FY 04	FY 05	FY 06
Sales	4169.3	5574.1	6642.3	6945.8
Excise Duty	179.0	226.6	267.4	270.0
Net Sales	3990.3	5347.5	6374.9	6675.8
Other Income	11.6	97.4	147.9	1581.2
Total Income	3980.3	5906.0	6638.9	8583.3
Total Expenditure	2666.0	4106.6	4755.9	6146.7
Operating Profit	1314.3	1799.4	1883.0	2436.6
Interest	287.6	203.7	82.0	96.1
Gross Profit	1026.7	1595.7	1801.0	2340.5
Depreciation	72.0	116.3	191.0	223.4
Profit Before Tax	954.7	1479.4	1610.0	2117.1
Tax	204.2	233.3	307.3	293.3
Reported Net Profit	750.5	1246.1	1302.7	1823.8
Extraordinary Items	-8.6	-13.4	-3.1	654.4
PAT	759.1	1259.5	1305.8	1169.4
EPS	76.4	99.7	8.5	11.7

Consolidated Qrtly Financials (Rs Mn)	Q2 FY06	Q2 FY05	% Chng	H1 FY06	H1 FY05	% Chng
Net Sales	3731.8	2915.9	28.0	8153.4	4459.2	82.8
Raw Material Cost	2017.5	1621.0	24.5	4596.2	2528.0	81.8
Other Expenses	672.2	484.9	38.6	1347.4	787.4	71.1
R&D Expense	226.3	89.0	154.2	403.3	141.7	184.6
Employee Cost	473.0	266.4	77.6	928.2	377.1	146.2
Total Expenditure	3389.0	2461.3	37.7	7275.1	3834.2	89.7
Operating Profit	342.8	454.6	-24.6	878.3	625.0	40.5
Other Income	128.6	175.1	-26.6	268.2	353.3	-24.1
PBDIT	471.4	629.7	-25.1	1146.5	978.3	17.2
PBDIT Margin (%)	12.6	21.6		14.1	21.9	
Interest	194.5	27.7	601.3	351.5	38.5	813.1
PBDT	276.9	602.0	-54.0	795.0	939.8	-15.4
Depreciation	128.3	84.5	51.9	265.6	138.4	92.0
PBT	148.6	517.5	-71.3	529.4	801.5	-33.9
PBT Margin (%)	4.0	17.7		6.5	18.0	
Exceptional Items	0.0	0.0		0.0	0.0	
Tax	-6.2	73.7	-108.4	19.0	104.7	-81.9
PAT	154.8	443.8	-65.1	510.4	696.8	-26.7
PAT Margin (%)	4.1	15.2		6.3	15.6	
Equity Capital	308.0	299.5		308.0	299.5	
EPS Diluted (Rs.)	1.0	2.9		3.2	4.5	

Balance Sheet (Rs Mn)	FY 03	FY 04	FY 05	FY 06
SOURCES OF FUNDS :				
Share Capital	123.0	127.2	299.5	307.3
Reserves Total	892.6	1654.6	5934.1	8333.9
Total Shareholders Funds	1015.6	1781.8	6233.6	8641.2
Secured Loans	1162.8	1979.7	394.9	1515.4
Unsecured Loans	144.0	95.4	65.7	42.5
Total Debt	1306.8	2075.1	460.6	1557.9
Net Deferred Tax	140.0	275.6	175.2	329.4
Total Liabilities	2462.4	4132.5	6869.4	10528.5
APPLICATION OF FUNDS :				
Gross Block	1651.4	3091.4	4322.8	4789.2
Less : Accumulated Depre.	294.6	837.4	999.2	1173.8
Net Block	1356.8	2254.0	3323.6	3615.4
Capital Work in Progress	153.8	415.9	387.5	556.7
Investments	34.1	31.0	1594.9	3440.4
Current Assets				
Inventories	700.7	1251.1	1710.1	1958.4
Sundry Debtors	561.7	941.5	1367.5	2032.4
Cash and Bank	87.2	36.1	87.6	177.7
Loans and Advances	349.2	587.1	1258.2	2125.8
Total Current Assets	1698.8	2815.8	4423.4	6294.3
Less : Current Liabilities and Provisions				
Current Liabilities	631.4	1084.3	2050.0	2423.3
Provisions	149.7	299.9	810.0	955.0
Total Current Liabilities	781.1	1384.2	2860.0	3378.3
Net Current Assets	917.7	1431.6	1563.4	2916.0
Total Assets	2462.4	4132.5	6869.4	10528.5

Ratios (%)	FY 03	FY 04	FY 05	FY 06
Debt-Equity Ratio	1.22	1.21	0.32	0.14
Current Ratio	1.39	1.16	1.18	1.23
Fixed Assets T/o Ratio	4.22	2.35	1.79	1.52
Inventory T/o Ratio	8.76	5.71	4.49	3.79
Debtors T/o Ratio	13.18	7.42	5.75	4.09
EBIDTA (%)	31.52	32.28	28.35	24.19
PAT (%)	18.00	22.36	19.61	16.84
ROCE (%)	91.10	54.48	32.07	17.25
RONW (%)	124.57	90.06	32.52	15.72

DISCLAIMER

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